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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1937

No. 772

LINDSAY-STRATHMORE IRRIGATION DISTRICT,

Appellant,

vs.

MILO W. BEKINS and REED J. BEKINS, as Trustees Appointed by the Will of Martin Bekins, Deceased, et al.,

Appellees.

BRIEF OF THE STATES OF CALIFORNIA, MISSISSIPPI, MISSOURI, NEVADA, NEW MEXICO, OREGON AND WYOMING AS AMICI CURIÆ IN SUPPORT OF APPELLANT.

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INTRODUCTORY STATEMENT.

The States of California, Mississippi, Missouri, Nevada, New Mexico, Oregon and Wyoming are vitally interested in the outcome of the above-entitled cause

and their undersigned legal representatives, by leave of the Court, present this brief as *amici curiæ* and urge that the judgment of the District Court of the Southern District of California, holding Chapter X of the National Bankruptcy Act unconstitutional, should be reversed.

The learned District Judge in his opinion frankly declared his personal view to be that the statute was a valid exercise of the bankruptcy power, but he concluded that he was bound under the decision of this Court in

> *Ashton v. Cameron County Water Improvement District No. 1,* 298 U. S. 513,

in which Chapter IX of the Bankruptcy Act was held to be an invasion of the reserved rights of the States, to make the same ruling with respect to Chapter X. We respectfully submit that the decision of the District Court is erroneous for at least three cogent reasons:

> *First,* Chapter X was carefully framed to meet the objections of this Court to Chapter IX;
>
> *Second,* The analogy between the implied limitation on the Federal taxing power and the bankruptcy power, which was the basis of the decision in the *Ashton* case, does not, under recent decisions of this Court, support the conclusion in that case;
>
> *Third,* Chapter X is essentially different from Chapter IX and does not in any way endanger or affront any sovereign rights of the States.

INTEREST OF AMICI CURIÆ.

The States we represent contain numerous taxing agencies that are burdened with indebtedness which they have been unable to meet, and which most of them

never can meet because of the excessive amount of the original indebtedness or because of the accumulation of unpaid interest and matured principal resulting from the inability of the landowners during the depression to raise money for the taxes levied for such obligations. These agencies are not seeking to repudiate their indebtedness. They have made heroic efforts to perform the impossible until it has been demonstrated over and over again that efforts to compel the payment of taxes in excess of the productive possibilities of the land result in rapidly diminishing returns and the ultimate collapse of the machinery of taxation. In nearly every such case plans of composition of the outstanding indebtedness have been agreed to by large majorities of the creditors, who are as anxious as the taxing agencies themselves to effect the consummation of these plans, but in nearly every such case there is a small minority of militant creditors who have refused to accept anything less than the full amount legally due them, although they well know that it is impossible for all creditors to be paid on that basis.

It is the purpose of Chapter X of the Bankruptcy Act, approved August 16, 1937, to assure equitable treatment for all the creditors of such taxing agencies by the confirmation of their plans of composition in open court after full hearing and thus bind all of the creditors to accept what the holders of at least two-thirds of the outstanding obligations have determined is the most that can be obtained. Chapter X provides that such a plan cannot be confirmed by the court until it has been accepted by or on behalf of such a majority of creditors and until the court finds that the plan is fair, equitable and for the best interests of the creditors, and does not discriminate unfairly in favor of any creditor or class of creditors, and has been offered

and accepted in good faith, and that the petitioner is authorized by law to take all action necessary to be taken by it to carry out the plan.

As the legal representatives of sovereign States, we have been unable to discover in this statute any violation of the reserved rights of the States or any provision that would subject our taxing agencies to the will of Congress or interfere with their free determination of their fiscal policies.

We assume, as this Court stated with reference to Chapter IX, that Chapter X is "adequately related to the subject of bankruptcies", and, as we believe this carefully limited extension of the privileges of the bankruptcy courts to public agencies will be of immense benefit to our respective States by making possible the orderly and equitable solution of otherwise baffling financial problems and that the new statute has been drawn with meticulous pains to avoid any interference with the sovereign rights of the States, we respectfully urge that it be upheld and that the judgment of the District Court be reversed.

I.

CHAPTER X HAS BEEN CAREFULLY FRAMED TO MEET THE OBJECTIONS OF THIS COURT TO CHAPTER IX.

The purposes to be accomplished by Chapter X of the Bankruptcy Act are essentially the same as were sought to be accomplished by Chapter IX, but the report of the hearings on the measure before the Subcommittee of the Judiciary Committee of the House of Representatives, which considered two bills to meet the decision holding Chapter IX unconstitutional, shows that Chapter X was prepared with great care to meet the objections set forth in the majority opinion in the *Ashton* case, particularly that the respondent in that

case was a political subdivision of the State created for the local exercise of sovereign powers and that its fiscal affairs were those of the State, "not subject to control or interference by the National Government, unless the right so to do is definitely accorded by the Federal Constitution", and the further objections that the application of the provisions of Chapter IX "might materially restrict respondent's control over its fiscal affairs", that if the obligations of States or their political subdivisions might be subject to the interference attempted in Chapter IX, they were "no longer free to manage their own affairs" and "the will of Congress prevails over them", and that if that act were sustained, the Federal Government, acting under the bankruptcy clause, might "impose its will and impair state powers—pass laws inconsistent with the idea of sovereignty".

While it was not specifically pointed out in the decision in the *Ashton* case how these results would follow from the provisions of Chapter IX, the report of the Judiciary Committee to the House of Representatives shows clearly the purpose of Congress to preserve the rights of the States in the new enactment. After stating that the committee believed the new measure would be welcomed by debtors and creditors alike, the report declared:

> "The bill here recommended for passage expressly avoids any restriction on the power of the States or their arms of government in the exercise of their sovereign rights and duties. No interference with the fiscal or governmental affairs of a political subdivision is permitted. The taxing agency itself is the only instrumentality which can seek the benefits of the proposed legislation. No involuntary proceedings are allowable, and no control or jurisdiction over that property and those

revenues of a petitioning agency necessary for essential governmental purposes is conferred by the bill."

Under such circumstances the strong presumption that the constitutional objections to the former enactment have been avoided in the enactment of a measure expressly designed to meet them, was declared by this Court in

Wright v. Vinton Branch of the Mountain Bank, 300 U. S. 440.

II.

THE ANALOGY BETWEEN THE IMPLIED LIMITATION ON THE FEDERAL TAXING POWER AND THE BANKRUPTCY POWER, WHICH WAS THE BASIS OF THE DECISION IN THE ASHTON CASE, DOES NOT, UNDER RECENT DECISIONS OF THIS COURT, SUPPORT THE CONCLUSION IN THAT CASE.

The decision of the majority of the Court in the *Ashton* case appears to have been based rather upon the fear of the consequences of possible extensions of the bankruptcy power if its application to the affairs of public taxing agencies were allowed than of the consequences of the specific provisions of that statute, and it was held that the same implied limitation upon the taxing power of the Federal Government which this Court had long recognized, should be applied to the bankruptcy power. This Court, however, in

Helvering v. Mountain Producers Corporation, decided March 7, 1938,

has clearly defined the scope of the implied limitation upon the Federal taxing power, and we respectfully submit that, by analogy of the rule established in that decision, the bankruptcy power may be properly exercised as set forth in Chapter X, because there is in truth

no "direct and substantial interference" with any of the functions of the State agencies authorized to take advantage of its provisions and there is "only remote, if any, influence upon the exercise of the functions" of these taxing agencies.

In the case just cited two decisions of this Court were expressly overruled on the ground that later distinctions had "attenuated their teachings" and that they were out of harmony with other decisions of the Court. In summing up this Court's conclusions from the decisions reviewed, it was said:

> "These decisions in a variety of applications enforce what we deem to be the controlling view—that immunity from nondiscriminatory taxation sought by a private person for his property or gains because he is engaged in operations under a government contract or lease cannot be supported by merely theoretical conceptions of interference with the functions of government. Regard must be had to substance and direct effects."

This is in harmony with decisions of this Court regarding alleged interference by the States with interstate commerce. Thus in

American Mfg. Co. v. City of St. Louis, 250 U. S. 459,

it was held that an excise tax levied by a State on articles carried in interstate commerce which has only a remote effect on such commerce is valid. The principle governing the implied limitation on the Federal taxing power, quoted above, is in direct line with the following statement of this Court in

Hump Hairpin Co. v. Emmerson, 258 U. S. 290, 294:

> "The turning point of these decisions is, whether in its incidence the tax affects interstate commerce

so directly and immediately as to amount to a genuine and substantial regulation of, or restraint upon it, or whether it affects it only incidentally or remotely so that the tax is not in reality a burden, although in form it may touch and in fact distantly affect it."

The bankruptcy power, like the taxing power, is conferred upon Congress in the broadest possible terms. Any implied limitation upon it must therefore be construed with the utmost strictness and limited to preventing actual invasions of the reserved rights of the States. To paraphrase the language of this Court in the foregoing quotations, the Congressional authorization to specifically defined State agencies to apply to the bankruptcy court to confirm their agreements with creditors, for the sole purpose of making them binding upon all creditors, must not be frustrated on account of "merely theoretical conceptions of interference with the functions" of such agencies, but "regard must be had to substance and direct effects", and before such a statute should be held unconstitutional, it must appear that there is "a genuine and substantial" restraint upon the exercise of some reserved right of the States.

This view disposes of the suggestion that if the right of Congress to authorize voluntary applications to the bankruptcy court by taxing agencies is upheld, Congress may then authorize involuntary proceedings against such taxing agencies or even extend the power of the bankruptcy court to the States themselves. This ignores the potency of the implied limitation upon the bankruptcy power to protect the States and their taxing agencies from any actual invasion of their rights or any attempt on the part of Congress to impose its will in restraint of the exercise of such rights.

Ever since the decisions of this Court in

The Passanger Cases, 7 How. 283, and

Washington University v. Rouse, 8 Wall. 439,

it has been recognized that the consideration of constitutional questions as to the power of Congress is not foreclosed by former decisions, and, insofar as the decision in the *Ashton* case is out of harmony with other, and especially with later, decisions of this Court regarding implied limitations on express Constitutional grants of legislative power, there should be no hesitancy in declaring that it is not to be regarded as authority.

III.

CHAPTER X IS ESSENTIALLY DIFFERENT FROM CHAPTER IX AND DOES NOT IN ANY WAY ENDANGER OR AFFRONT ANY SOVEREIGN RIGHT OF THE STATES.

While the purposes to be accomplished under Chapter X are essentially the same as were sought to be accomplished under Chapter IX, a comparison of the two chapters confirms the above-quoted statement of the House Judiciary Committee that the new measure avoids any restrictions on the power of the States or their arms of government in the exercise of their sovereign rights and duties.

1. Chapter X makes it clear that the jurisdiction of the Court is limited to the confirmation of plans of composition, which, as was pointed out in

Nassau Smelting & Refining Works, Ltd., v. Brightwood Bronze Foundry Company, 265 U. S. 269,

are in all respects voluntary proceedings between debtors and creditors, leaving to the court *only the power to enforce upon dissenting creditors the will of*

the majority. Chapter IX provided for the confirmation of plans of "readjustment". Its structure was analogous to the provisions of Section 77 of the Bankruptcy Act providing for the reorganization of railroads and Section 77b providing for corporate reorganizations generally, in which the powers of the court were exercised on both debtors and creditors. Furthermore, Subsection (i) of Section 80 in Chapter IX contained the following provision:

> "In proceedings under this chapter and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the taxing district and the rights and liabilities of creditors, and of all persons with respect to the taxing district and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the petition of the taxing district was approved."

This drastic language implied distinctly the subjection of the taxing district and its property to the power of the bankruptcy court. *No such provision is found in Chapter X.*

2. In Subdivision (3) of Subsection (c) of Section 80 in Chapter IX it was provided that the judge "shall require the taxing district at such time or times as the judge may direct, and in lieu of the schedules required by Section 7 of this Act, to file such schedules and submit such other information as may be necessary to disclose the conduct of the affairs of the taxing district and the fairness of any proposed plan", and it was further provided in Subdivision (7) of said Subsection (c) that the judge "may require the taxing district to open its books, records, and files to the inspection of

any creditor of the taxing district during reasonable business hours". No such provisions are contained in Chapter X.

If it be suggested that these provisions are essential to the protection of the rights of creditors, the answer is that, as these taxing districts are public agencies, their records, to such extent as the respective States may deem proper, are open to public inspection. To give the bankruptcy court inquisitorial powers over such districts might reasonably be considered an affront to State sovereignty. Of course, unless the petitioning district frankly presents at the hearing the facts regarding its financial condition, it cannot show that its plan of composition is fair and equitable, but the theory of Chapter X is that these state agencies should be left free to manage their own affairs and present their cases to the court on their merits without being subjected to any compulsion by the court itself.

3. In Subdivision (11) of said Subsection (c) of Section 80 it was provided that the court should not by any order or decree interfere with any of the property or revenues of the taxing district necessary "in the opinion of the judge" for essential governmental purposes. This quoted language has been eliminated from the corresponding provision in Chapter X.

4. In Subsection (e) of Section 80 it was provided that before a plan was confirmed changes and modifications might be made therein "with the approval of the judge after hearing upon notice to creditors", subject to the right of any creditor who had previously accepted the plan to withdraw his acceptance. In Chapter X it is expressly provided in Subdivision (c) of Section 83 that any changes or modifications of the

plan of composition must be subject to their acceptance in writing by the petitioner.

5. In Subsection (f) of Section 80 in Chapter IX it was provided that upon confirmation of a plan "the provisions of the plan and of the order of confirmation shall be binding upon (1) the taxing district, and (2) all creditors, secured or unsecured" etc. Under this provision drastic orders might be made imposing the will of the court in various details upon the taxing district. In Subdivision (f) of Section 83 it is provided that if an interlocutory decree confirming the plan is entered, the plan and the decree shall become and be binding upon all creditors affected by the plan "if within the time prescribed by the interlocutory decree, or such additional time as the judge may allow, the money, securities, or other consideration to be delivered to the creditors under the terms of the plan shall have been deposited with the court or such disbursing agent as the court may appoint or shall otherwise be made available for the creditors". This confirms the purely voluntary nature of the proceeding authorized by Chapter X. Of course, the district is bound by its agreement with the creditors who have accepted the plan, *but it is bound under its general authority from the State to make contracts, and not by virtue of the decree of the bankruptcy court,* and it is only when the consideration for the composition has been posted by the debtor that the decree itself becomes binding upon the dissenting creditors.

We respectfully submit that these distinctions are of substance and not merely of form and that they meet the objections of the majority of the Court to Chapter IX as effectively as the enactment of the second Frazier-

Lemke Act met the objections to the first. Accordingly, we contend that the learned judge of the District Court was in error in holding that there was no essential difference between the provisions of Chapter IX and the provisions of Chapter X, and therefore, as well as for the other reasons heretofore stated, the judgment should be reversed and that the petition of Lindsay-Strathmore Irrigation District for confirmation of its plan of composition should be heard on its merits by the District Court.

Dated April 1, 1938.

Respectfully submitted,

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